

JOURNAL OF SOCIAL AND POLITICAL STUDIES

December 2012

Volume III (2)

ISSN-2229-3647

A Bi-annual Journal of Department of Political Science,
University of Allahabad, Allahabad-211002 (INDIA)

The Strange Case of Dr Hayek and Mr Hayek

Mark Lindley and James Farmelant

Everyone familiar with American politics of the last few years knows that the Tea Party and Fox News idolized Friedrich von Hayek and that Glenn Beck, a renowned (not to say notorious) Fox-News pundit, caused Hayek's sharpest book, *The Road to Serfdom* (1945), to become a national best seller in 2010.¹ Relatively few people, however, know the other interesting facts about Hayek. Here are two samples: (1) He considered John Maynard Keynes to have been "the one really great man I ever knew."² (2) While shouting from the rooftops (as it were) that "'social justice' is a mirage"³ and that "what is called 'distributive justice'" should "really be called 'anti-social',"⁴ he would explain, when expressing himself more calmly, that in societies which have "reached the general level of wealth which ours has attained," it would be OK for the government to legislate a maximum number of permissible working-hours ("if it is not carried too far") and a universal minimum wage level; and, "there can be no doubt that some minimum of food, shelter, and clothing, sufficient to preserve health and the capacity to work, can be assured to everybody" by "governmental services."⁵

Hayek was an academic economist, then a political activist, then a philosopher of socio-political order and a would-be historian. There are remarkably interesting things to know about each of these aspects of his work. Although his writings on economics are seldom cited nowadays by other economists, his ideology is still quite influential in American politics. This essay, designed for readers with no very deep background in academic economic theory, will describe some of his main intellectual achievements and failures, and will show that what was mainly wrong about him was not so much his intellectual limitations (everyone has such blind spots) as some salient and persistent defects of personal character. We will cite Keynes several times on account of Hayek's interesting historical and personal relationship with him. (Our assessment of Keynesian economics would make a very different essay.)

The pivotal doctrine in Hayek's teaching as a youngish economics professor in London in the 1930s (he was born in 1899) was that when consumers instead of spending their money put it in a bank, which they will do if and only if the interest rate is attractive, they are automatically – even though they don't know it – demanding economic expansion, because "changes in voluntary saving" are "simple shifts of demand between consumers' goods and producers' goods":⁶

"[I]t is certainly not true to say that the demand for capital goods in general is directly determined by the magnitude of the demand for consumers' goods.... [W]e must certainly take the fluctuations in the supply of free capital, and not the fluctuations in the demand for consumers' goods, as the starting point.... [G]eneral increase in the demand for capital goods ... is due to an increase in the supply of saving."⁷

This automatic demand for investment and hence for more "producers' goods" instead of consumers' goods would allegedly create more jobs, whereas buying things you need (or just want) would, according to Hayek, cause people to be thrown out of work: when one of Keynes's students asked Hayek, "Is it your view that if I went out tomorrow and bought an overcoat, that would increase unemployment?", he replied, "Yes, but it would take a very long mathematical argument to explain why."⁸ (He had in mind, as we will see, no statistics and no on-the-ground facts, but only algebra.) He dismissed Keynes's view that

"thrift may be the handmaid and nurse of enterprise. But equally she may not.... For enterprise is connected with thrift not directly but at one remove.... [T]he engine which drives enterprise is not thrift but profit."⁹

According to Keynes,

"The amount of savings is a function of income; the amount of income is determined by the volume of production: i.e. by the volume of consumption plus investment. Thus if investment, i.e. that part of production which is not consumed, falls off, income falls off, and therefore savings fall off.... Instead of saving determining investment, it is much truer to say that investment determines saving – though this is in fact too simple."¹⁰

Hayek was very well aware of complexities in economic theory, and displayed a stunning erudition in his discussions of them. The following sample (omitting the seven footnotes) shows this impressive aspect of his work as an economist:

“As regards the relationship of the natural or equilibrium rate of interest to the actual rate, it should be noted, in the first place, that even the existence of this distinction is questioned. The objections, however, mainly arise from a misunderstanding that occurred because K. Wicksell, who originated the distinction, made use in his later works of the term ‘real rate’ (which to my mind is less suitable than ‘natural rate’) and this expression became more widespread than that which we have used. The expression ‘real rate of interest’ is also unsuitable, since it corresponds with Professor Fisher’s ‘real interest,’ which, as is well known, denotes the actual rate plus the rate of appreciation or minus the rate of depreciation of money, and is thus in accordance with the common usage, which employs the term ‘real wages’ or ‘real income’ in the same sense. Unfortunately Wicksell’s change in terminology is also linked up with a certain ambiguity in his definition of the ‘natural rate.’ Having correctly defined it once as ‘that rate at which the demand for loan capital just equals the supply of savings,’ he redefines it, on another occasion, as that rate which would rule ‘if there were no money transactions and real capital were lent *in natura*.’ If this last definition were correct, Dr. G. Halm would be right in raising, against the conception of a ‘natural rate,’ the objection that a uniform rate of interest could develop only in a money economy, so that the whole analysis is irrelevant. If Dr. Halm, instead of clinging to this unfortunate formula, had based his reasoning on the correct definition, which is also to be found in Wicksell, he would have reached the same conclusion as Professor Adolf Weber – the distinguished head of the school of which he is a member: that is, that the natural rate is a conception ‘which is evolved automatically from any clear study of economic interconnections.’ In accordance with this view, Wicksell’s conception must be credited with fundamental significance in the study of monetary influences on the economic system; especially if one realizes the practical importance of a money rate of interest depressed below the natural rate by a constantly increasing volume of circulating media. Unfortunately, although Wicksell’s solution cannot be regarded as adequate at all points, the attention it has received since he propounded it has borne no relation to its importance. Apart from the works of Professor Mises, mentioned above, the theory has made no progress at all, although many questions concerning it still await solution. This may be due to the fact (on which we have touched already) that the problem had become entangled with that of fluctuations in the general price level. We have already stated our views on this point....”¹¹

The man who invited Hayek from Vienna to London in 1931 and got him his professorship was Lionel Robbins, who had been appointed, two years earlier, head of the Economics Department at the London School of Economics. Forty years later, Robbins recalled:

“The focus of our intellectual activity was the seminar.... As a matter of form it was described as being held by Hayek and myself; and I usually took the chair. But ... staff and students alike were a band of eager seekers after truth.... ‘Bliss was it in that dawn to be alive / But to be young was very heaven!’

“I was ... an anti-expansionist where public expenditure [i.e. expenditure by the government] was concerned, at a time [i.e. during the Great Depression] when ... I should have been on the other side.... I had become the slave of theoretical constructions which, if not intrinsically invalid as regards logical consistency, were inappropriate to the total situation ... and which therefore misled my judgment. I realized that these considerations led to conclusions which were highly unpalatable as regards practical action. But I was convinced that they were valid and that therefore it was my duty to base recommendations as regards policy upon them.... The basic theory from which these unhappy conclusions seemed to flow was not a new one.... But it had recently been given much greater coherence by the work of the so-called second Viennese school, conspicuously [Ludwig] von Mises [Hayek’s philosophical mentor¹²] and Hayek.... [W]hen I made its acquaintance, as I did in the late twenties, it affected my thought powerfully.

“Now I still think that there is much in this theory as an explanation of a *possible* generation of boom and crisis. I suspect that there are some episodes in economic history, the railway crisis of 1847 and the American crisis of 1907 for instance, on which it can cast valuable light.... But, as an explanation of what was going on in the early thirties, ...[t]he theory was inadequate to the facts.

“Nor was this approach any more adequate as a guide to policy.... Assuming that the original diagnosis of excessive financial ease [i.e. excessively low interest rates] was correct – which is certainly not a settled matter – to treat what developed subsequently in the way which I then thought valid was as unsuitable as denying blankets and stimulants to a drunk who has fallen into an icy pond, on the ground that his original trouble was overheating. I shall always regard this aspect of my dispute with Keynes as the greatest mistake of my professional career.”¹³

The facts as to “what was going on” were statistical; a responsible economics professor wouldn’t draw a general conclusion merely from some anecdotes. But it was a basic premise of Hayek’s method as an econo-

mist that, as he himself put it, “I don’t think statistical information has anything to contribute to the theoretical explanation of the process.”¹⁴ This is why Milton Friedman’s opinion of Hayek as an economist was so severe:

“I never could understand why [people at the London School of Economics] were so impressed with the lectures [given there by Hayek] that ended up as *Prices and Production*, and I still can’t.... [Hayek] had not freed himself from the methodological views of von Mises... [according to which] facts are not really relevant in determining, in testing, theories ... because we base economics on propositions that are self-evident ... because they are about human beings, and we’re human beings. So we have an internal source of final knowledge, and no tests can overrule that.... If you’re always going back to your internal, self-evident truths, how do people [i.e. economic theorists] stand on one another’s shoulders? And the fact is that fifty, sixty years after von Mises issued his capital theory – which is what’s involved in Hayek’s capital theory – so-called Austrian economists still stick by it. There hasn’t been an iota of progress.... If you and I disagree about whether some proposition or statement is correct, how do we resolve that disagreement?... We [would] have [on Hayek’s basis of allegedly self-evident truths in economic theory] no way to resolve it except by fighting, by saying you’re wrong and I’m right.”¹⁵

Hayek had a psychological explanation for how it could be that Robbins would change his mind:

“Keynes had got Lionel Robbins around, as a result of working together in government circles during the war.... [A]ll economists who serve in government are corrupted as a result of serving in government.”¹⁶

Did he mean that Keynes and Robbins had collaborated in taking bribes? No, he was just fond of punchy language and needed it to explain why his champion had committed apostasy. But actually the last sentence of Robbins’s statement implies that he regretted only one aspect of his theoretical dispute with Keynes; the fact of the matter, as noted by Robbins’s biographer, is that

“Starting from a basis of knowledge of Classical monetary theory, and of Wicksell [an eminent Swedish economist], he espoused [in the 1930s] the Mises-Hayek theory of the trade cycle, which led him into an intransigent position ... concerning fiscal policy as a means of countering depression. In the post-war years he abandoned both the opposition to fiscal policy and the close adherence to the Mises-Hayek version of monetary theory; but in doing so he retreated to the Classical and Wicksellian roots of that theory”¹⁷

—and thus never became a Keynesian. Hayek’s belief that “Keynes had got Lionel Robbins around” and that both of them had been “corrupted” was due to wounded vanity rather than to a grasp of what had happened. (Keynes for his part was Keynesian before being called upon to serve in government.)

Not only Keynes and Friedman (and Robbins later) but also a host of other brilliant economists, including John Hicks, Frank Knight, Gunnar Myrdal and Piero Sraffa,¹⁸ saw severe defects in Hayek’s theoretical work as an economist in the early 1930s. According to a sympathetic and well-informed biographer of Hayek,

“The combined effect was to start Hayek on a long process of rethinking his economics.... After seven years of work, he produced [in 1941] a four-hundred page book [actually more than 475], *The Pure Theory of Capital* ... but still the task was unfinished. He admits as much in the preface:

“‘I fear, however, that the reader will find the actual shortcomings of this book not so much in its limitation to the more abstract problems but rather in the fact that even within these limits it leaves some problems of real importance unsolved.... I can only plead that I have grappled honestly and patiently with what even now appears to me by far the most difficult part of economic theory, and that the present book with all its shortcomings is the outcome of work over a period so prolonged that I doubt whether further effort on my part would be repaid by the results.’”¹⁹

The issues which Hayek had in mind when writing this confession that he had failed and could never succeed as a theorist of capital (a central topic of economic theory ever since Karl Marx) had to do with questions like (a) what to make of the fact that interest rates may be regarded as the price of capital when it is borrowed or lent, and, more broadly, (b) how its value is related to *time* when it comes to choosing between initially quicker but more labor-intensive methods of production (such as, for instance, in a shoe maker’s shop) and initially more “roundabout” but eventually more ample methods (in, say, an automated shoe-factory). However, there is another set of issues which theorists of capital should, in our opinion, take into account nowadays, but which Hayek ignored. Year by year in the 21st century it is becoming increasingly clear that ecological degradation can cause massive losses of capital, as land becomes agriculturally impoverished, the

weather becomes more destructive (sometimes wiping out entire cities, and that is just one aspect of it), the human capital of a healthy population is diminished by poisoning of various kinds, by the inadvertent development of super-bacteria and other causes of new kinds of epidemics, etc. As we witness the capacity of ecological factors to destroy capital, we can sense that they have always been essential to its creation and maintenance. They were traditionally regarded as having been granted by Providence (...“world without end, Amen”). William Petty held, in the 17th century, that “all things ought to be valued by two natural Denominations,... Land and Labour,”²⁰ and Hayek accepted this precept; but the modern understanding of cosmology, natural history, climatology, chemistry (including biophysical chemistry), nutrition etc. is such that the concept of “land” can no longer cover the gamut of necessary ecological conditions. And as we realize, in thinking about cause and effect in economics, that every given effect has a large set of causes, we can see that any intelligent modern person honestly trying to produce a correct theory of capital while committed to ignoring all the ecological factors is bound sooner or later to “doubt whether further effort on his part would be repaid by the results.” Hayek did mention “depreciation” in his book, but had no inkling of complicated ecological issues (presumably because his own training was extremely weak in physics, chemistry, biology, geology, natural history, etc.). The theories of Keynes (who studied physics, chemistry and biology at Oxford) are, in our opinion, no better in this regard.

The main bridge between Hayek’s theories as an economist and as a socio-political philosopher was an interesting idea expressed most clearly in an article published in 1945. It belonged to an important line of thought which Mises had initiated in 1920 by arguing that no government can make competently the economic calculations required to organize a complex economy and so the only “rational” way to do it is by reducing – via the market – all values to monetary terms and letting the market determine the intricate allocations of investment and production. Here is a representative excerpt from Mises’s argument:

“The human mind cannot orientate itself properly among the bewildering mass of intermediate products and potentialities of production without such aid [i.e. without the aid of the give and take of the market].... It would simply stand perplexed before the problems of management and location. It is an illusion to imagine that in a socialist state, calculation *in natura* [i.e. in terms of the actual goods and services themselves] can take the place of monetary calculation. Calculation *in natura*, in an economy without [monetary] exchange, can embrace consumption-goods only: it completely fails when it comes to deal with goods of a higher order [such as factory machines, transportation, etc.]. And as soon as one gives up the concept of a freely established monetary price for goods of a higher order, rational production becomes impossible. Every step that takes us away from private ownership of the means of production and from the use of money also takes us away from rational economics.”²¹

Hayek’s extension of the argument was as follows:

“All economic activity is ... planning [of some kind or other]; and in any society in which many people collaborate, this planning, whoever does it, will in some measure have to be based on knowledge which, in the first instance, is not given to the planner but to somebody else, which somehow will have to be conveyed to the planner. The various ways in which the knowledge on which people base their plans is communicated to them is the crucial problem for any theory explaining the economic process.... We cannot expect that this problem will be solved by first communicating all this knowledge to a central board which, after integrating all knowledge, issues its orders. We must solve it by some form of decentralization. But this answers only part of our problem ... [since] the ‘man on the spot’ cannot decide solely on the basis of his limited but intimate knowledge of the facts of his immediate surroundings. There still remains the problem of communicating to him such further information as he needs to fit his decisions into the whole pattern of changes of the larger economic system. How much knowledge does he need to do so successfully? ...[T]his problem ... can be solved, and in fact is being solved, by the price system.”²²

This clever idea represents a step away from the standard 20th-century academic “perfect-competition” kind of theoretical model whereby every individual is assumed to know everything of importance for his or her market decisions. (And Hayek’s idea is thus irrelevant to current academic theory of economics.) It has two weaknesses as *political* philosophy for the 21st century. (1) In keeping with Mises’s precept reducing all values to one-dimensional monetary terms, the “rational” way to counteract the future negative effects of various kinds of ecological degradation upon people as yet unborn (and hence unable to bid in the current market) is by “discounting,” that is, by positing a monetary cost at a specified future date and reckoning how much

less money than that – this is the discounting – should be set aside now (e.g. by putting it in a savings account) in order to swell to the amount of that cost by the date in question, given an assumed rate of annual increment and assuming that the supposed future total will be paid.²³ But what future monetary costs should be assigned to the vast macro-ecological catastrophes that are beginning to shape up today? And, how are businessmen to proceed with discounting in relation to those arbitrarily estimated monetary costs of massive long-term ecological degradation? An eminent American champion of capitalism, Lester Thurow, has described as follows the likely answer to the second of these questions:

“Using capitalistic decision rules, the answer to what should be done today to prevent such [vastly destructive ecological] problems is very clear.... However large the negative effects fifty to one hundred years from now might be, their current discounted net present value [to the corporation] is [practically] zero. If the current value of the future negative consequences is zero, then nothing should be spent today to prevent those distant problems from emerging. But [even] if the negative effects are very large fifty to one hundred years from now, by then it will be too late to do anything to make the situation better since anything done at that time could only improve the situation another fifty to one hundred years into the future. So being good capitalists, those who live in the future, no matter how bad their problems are, will also decide to do nothing. Eventually a generation will arrive who cannot survive in the earth’s altered environment, but by then it will be too late for them to do anything to prevent their own extinction.”²⁴

The kind of information which Hayek said is the *only* kind that should be heeded is thus inadequate to ensure the survival of humankind for the next few hundred years. Multi-dimensional measures are needed – such as medical practitioners use in making judgements about people’s health – rather than a one-dimensional measure such as market prices. It is a function of government to make such multi-dimensional assessments and to have some concern for citizens who are as yet unborn and are thus unable to bid in the market. In fairness to Hayek, we should mention that practically no mid-20th-century economists perceived this unfortunate relationship between the concept of discounting (which they accepted) and the problems of long-term, massive ecological degradation. But meanwhile (2) the other big defect in his clever insight is that it makes no allowance for the fact that in the modern world, most of the people “on the spot” are inundated with persuasive misinformation due to vast expenditures for deceptive advertising and propaganda. Marketing- and propaganda-experts know how to do this; economic theorists have ignored it. Hayek would cite Lord Acton’s famous precept (“All power tends to corrupt...”) in regard to government employees but never in regard to billionaires whose powers in the USA are greater today than ever before because they can pay, to own and control the media and to control the behavior of government officials, sums which outdo the sums available for research and for education in the sense of truth-seeking.

Karl Popper understood this latter point, even though he was, like Robbins and Keynes, a close friend of Hayek’s, and appreciated the market system, and agreed whole-heartedly (like Robbins and Keynes) with Hayek’s anti-Marxism. (Popper wrote the greatest book against Marxism, *The Open Society and its Enemies*; Keynes taught his students that Marxist economics is “complicated hocus-pocus.”²⁵) Here is part of an interview given by Karl Popper a few weeks before his death in 1994:

Interviewer: “Even though serious limitations of the free-market principle have become evident, its liberal [\approx libertarian] champions refuse to face the facts – very much like the communists not so long ago.”

Popper: “Well, I still believe that in a way one has to have a free market, but I also believe that to make a godhead out of the principle of the free market is nonsense. If we do not have a free market, then the things that are being produced are not produced for the consumer really. The consumer can take it or leave it; his needs are not [really] taken into account in the process of production. But all that is not of a fundamental importance. *Humanitarianism*, that is of fundamental importance.

“Traditionally, one of the main tasks of economics was to think of the problem of full employment [not a concern of Hayek’s]. Since approximately 1965 economists have given up on that; I find it very wrong. It cannot be an insoluble problem. It may be difficult, but surely it is not insoluble!

“Our first task is peace; our second task is to see that nobody be hungry; and the third task is fairly full employment. The fourth task is, of course, education.”

Interviewer: “...What kind of problems do you see as obstacles in achieving the task of education?”

Popper: “At present the greatest danger to the educational effort is television. Education just cannot go on if you let television do what it likes. It is impossible for education to work against television unless television recognizes that it also has an educational task which overrules our mere entertainment. Otherwise we cannot have

education. From the democratic point of view television must be controlled because of its potential political power which is almost unlimited.”²⁶

Robbins had declined to posit that “the only practical modes of economic organization were either completely free enterprise all round or [else] total collectivism.” Knowing modern British economic and political history as he did (knowing, for instance, about the Unemployed Workman’s Act of 1905, the Employment of Children Act of 1905, the National Insurance Act of 1911, and so on), he said that “economic history is a history of mixed systems – the practical question concerns always the degree of the mixture.”²⁷ Other thoughtful public figures in Britain agreed. Harold Macmillan, for instance, a Conservative-Party member of the House of Commons and later a remarkably successful prime minister, wrote in the mid-1930s a substantial book, *The Middle Way: A Study of the Problem of Economic and Social Progress in a Free and Democratic Society*, which included, in addition to a modicum of statistics, a wealth of remarks such as the following:

“A large proportion of our population is living in conditions of poverty.... A still larger proportion, including the great majority of the people, suffer the anxieties of insecurity.... The standard of life is generally higher, the system of [governmental] social services is more humane and more efficient than in any other country or at any earlier time. But there is a legitimate claim that standards which were endurable in an age of scarcity are unendurable when we have at our disposal a potential volume of production quite adequate to remove the old restrictions of scarcity....”²⁸

“I want to argue ... for the deliberate preservation of private enterprise in a field lying outside the range of minimum human needs. I support it for the purely economic reason that it ensures initiative, the adoption of new methods, the exploration of the market possibilities of new products, and speculative experimentation with new scientific discoveries. But, more than that, I mean to submit that freedom of individual initiative and enterprise in these fields is essential to the preservation of liberty, to the freedom of each person to live his life in his own way, and to provide for that diversity which is characteristic of the human mind.

“But I do not propose to employ this defence of private enterprise in the fields for which it is best suited in order to condone or excuse the poverty and insecurity in the basic necessities of life, which we have today as a legacy of unrestrained competition....”²⁹

“Government that engages in the task of creating the means by which we may begin to eradicate malnutrition in this country may be confident that it will be supported, not only by the people to be benefited, but by every person with a sense of society’s moral duty to its citizens.”³⁰ ...Fancy bread, scones, pastries, etc., etc., would remain in private hands, for here again we have the wide range of consumers’ choice. But the supply of plain bread produced to standard specifications must, in a nutrition policy worthy of the name, come within the control of the Nutrition Board.... It is not suggested that a State monopoly should be created in the baking of bread. Private enterprise would be free to continue.”³¹

The leading British economist of that era, Keynes, said that:

“The political problem of mankind is to combine three things: economic efficiency, social justice, and individual liberty. The first needs criticism, precaution, and technical knowledge; the second, an unselfish and enthusiastic spirit, which loves the ordinary man; the third, tolerance, breadth, appreciation of the excellencies of variety and independence, which prefers, above everything, to give unhindered opportunity to the exceptional and the aspiring.”³²

And as for Hayek himself, even sympathetic observers have noted that

“If one is judging his work against the standard of whether he provided a finished political philosophy, Hayek clearly did not succeed”³³

—and that his political philosophy is flawed by “fundamental difficulties,”³⁴ including self-contradictions. A little-noted instance is his self-contradictory views on copyright. In 1949 in a vituperative criticism of intellectuals, i.e. of educated writers who (like him, though he did not acknowledge it) are without “that experience of the working of the economic system which the administration of property gives” and thus without “direct responsibility for practical affairs,” he lamented that “the growth of this class [of despicable people] has been artificially stimulated by the law of copyright,”³⁵ but then in the course of denying implicitly in 1988 the possibility of such phenomena as Wikipedia, MIT OpenCourseWare, healthfinder.gov, pubmed.gov etc., he declared that “encyclopedias, dictionaries, textbooks and other works of reference could not be produced if, once they existed, they could freely be reproduced.”³⁶ More widely noted is the incompatibility between (a)

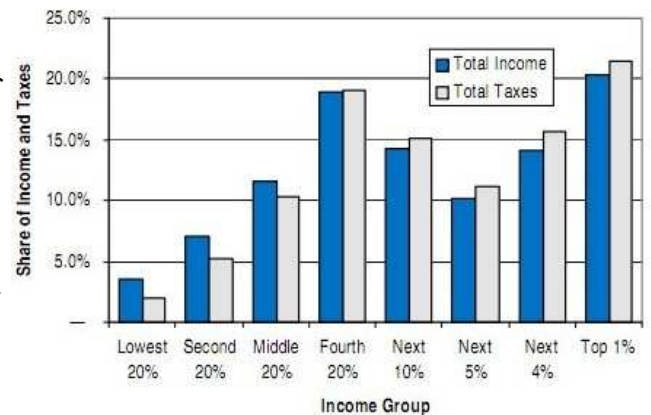
his adulation of the market as the *only* proper source of *morality* (see below) and (b) his theoretical acceptance of certain welfare-state provisions. The muddle is salient in the following passage:

“I would ... aim at completely eliminating all direct interference with the market – that all governmental services be clearly done outside the market, including the provision of a minimum floor for people who cannot make an adequate income in the market ... just providing outside the market a flat minimum for everybody. This, of course, means in effect eliminating completely the social justice aspect of it, that is, the deliberate redistribution beyond securing a constant minimum for everybody who cannot earn more than that minimum in the market.”³⁷

While there is no way in which giving a “flat minimum” to everyone who “cannot make an adequate income” can be done without intruding into the workings of the market, Hayek’s call for “eliminating completely the social justice aspect” has to do with a distinction which Keynes described more clearly than Hayek could:

“[I]t is true that the needs of human beings may seem to be insatiable. But they fall into two classes – those needs which are absolute in the sense that we feel them whatever the situation of our fellow human beings may be, and those which are relative in the sense that we feel them only if their satisfaction lifts us above, makes us feel superior to, our fellows. Needs of the second class, those which satisfy the desire for superiority, may indeed be insatiable; for, the higher the general level, the higher still are they. But this is not so true of the absolute needs.”³⁸

The distinction underlay Hayek’s opposition to the use of “progressive” income-tax rates, i.e. with the rich paying a larger percent of their income than the poor. He wanted neither that the poor (in affluent countries) should starve nor that the rich should contribute relatively more to pay for law enforcement to protect their property. (In the USA nowadays, the effect of progressive income-tax rates is offset to a considerable extent by other, “regressive” taxes, i.e. with the poor paying a larger share of their income than the rich. The relevant data from 2010 (see below) show that the poorest 20% of Americans had about 3½% of the income, and paid about 2% of the taxes, while the richest 1% had more than 20% of the income and paid about 21½% of the taxes.³⁹ If the net effect of all the taxation had not been progressive, the poorest 20% would have paid about 60% more than they did, while the richest 1% would have paid about 5% less than they did.)



These are just a few examples of how various salient facts about Hayek and his teachings become more interesting in the light of additional information. Many other examples are explained clearly in one of the best retrospective books about him, entitled *Contending with Hayek* and compiled in 1994 by the “Liberale Institut” in Zurich.⁴⁰

Hayek’s academic prestige in his later years was due to the fact that in 1974 the Bank of Sweden awarded him half of its sixth annual “Prize in Economic Sciences in Memory of Alfred Nobel.” (Alfred Nobel was a Swedish scientist who after becoming very rich from his inventions – especially the invention of dynamite – had established in 1895 a set of prizes for achievement in three branches of science, in literature, and in promoting peace, but no prize in regard to economics; that one was the Bank’s doing, long after Nobel had died.) The other half of its 1974 prize, however, went to Gunnar Myrdal, who was a far more effective economist than Hayek because (unlike Hayek) he investigated and heeded the facts on the ground⁴¹ and was instrumental in designing brilliantly for Sweden in the 1930s and ’40s the kind of welfare provisions which Hayek declared in 1944 would put any country that adopted them on the “road to serfdom.” But Hayek did not really mean serfdom. *That* was a legal status, somewhat like but not the same as slavery, in feudal Europe long ago and in Russia until 1861 (four years before slavery was abolished throughout the USA). Hayek in the title of his book was just blasting away with inflammatory language. Winston Churchill took a cue from this, during the 1945 election campaign in Britain, by declaring that Clement Attlee and the Labour Party if elected to power would, in the course of governing,

“fall back on some form of Gestapo, no doubt very humanely directed in the first instance, and this would nip in the bud opinion at its source, it would stop criticism as it reared its head, and it would gather all the power to the

supreme party and the party leaders rising like sacred pinnacles above their vast bureaucracy of civil servants – no longer servants and no longer civil!”⁴²

British voters were put off by this upper-class demagoguery, which Attlee promptly and correctly attributed to Hayek’s influence. They elected Attlee by a landslide, and no dictatorship ensued. Myrdal was correct when he remarked (in 1951) that

“All this popular talk about economic planning leading us straight to the Police State, and so on, is, if you permit me to be blunt, just bunk.”⁴³

Hayek’s political activism in Britain had started with academic politics in the 1930s when William Beveridge had been, since 1919, the head of the London School of Economics (but was not a member of its Department of Economics). According to Hayek,

“[T]he LSE economists [i.e. Hayek’s colleagues in the Department of Economics at the London School of Economics] ... had not had a classical education. There was a time when I concluded every departmental meeting by saying “*Beveridge delendus est.*” I found out that not one of them understood what I was saying. It’s a famous phrase, a story from, I believe, Cicero. *Ceterem censeo Catonum esse delendum.* It was his argumentation against Cato; and he is supposed to have concluded every speech in the Senate with, “Thus I believe that we must destroy Cato.”⁴⁴

He never explained what he meant by “destroying Beveridge.” He had merely found the hateful phrase “*delendus est*” irresistible – no matter that his later recollection of Roman history was defective. (Cicero (106-43 BC) and Cato the Younger (95-46 BC) were allies in the Senate, and the historical record provides no evidence of Cicero saying anything against Cato – whose great-grandfather, however, had habitually ended *his* Senate speeches by calling for the city of Carthage to be destroyed; and it had been done in a genocide forty years before Cicero was born, as everyone who has read ancient history knows: “All places were filled with groans, shrieks, shouts, and every kind of agony. Some were stabbed, others were hurled alive from the roofs to the pavement.... As the fire spread and carried everything down, the soldiers did not wait to destroy the buildings little by little, but all in a heap.... Street cleaners ... tossed ... the dead and the living together into holes in the ground, dragging them along like sticks and stones....”⁴⁵) How to explain Hayek’s personal venom toward his superior? Beveridge was a devoted public servant. Ten years before being appointed Director of the London School of Economics, he had published an influential study of unemployment in Britain, proposing “labour exchanges,” i.e. local offices where people offering jobs and people looking for them could readily find one other. At the School, his down-to-earth managerial diligence – “raising massive funds ... attracting a range of distinguished scholars in all branches of the social sciences” – were such that “by the early 1930s the LSE was recognized as one of the world’s leading centres of the social sciences,” and Beveridge himself was seen as mainly responsible for its prodigious growth.⁴⁶ But, he was just as conceited as Hayek (he was awarded honorary doctorates from thirteen universities in seven countries²⁹ – far more than Hayek); he was far less erudite than Hayek in regard to academic economic theory; and, without ever interfering in the slightest with Hayek’s teaching, he expressed on many occasions a deeply held belief⁴⁷ – quite incompatible with Hayek’s belief (cited above) that economic theory must never be based on statistical facts – that “the way ahead” in the social sciences “lay in empirical studies of social phenomena rather than in deductions based on analytical postulates about the nature of human behavior.”⁴⁸ This precept fit in very well with the original prospectus for the school (back in the 1880s), according to which

“The special aim of the School will be, from the first, the study and investigation of the concrete facts of industrial life and the actual working of economic and political relations as they exist or have existed.”⁴⁹

Here is an autobiographical account of Beveridge’s farewell address to the LSE:

“I took as my subject *The Place of the Social Sciences in Human Knowledge*. I illustrated my view of economics as we still had it in 1937, not by anything in the [London] School of Economics, but by reference to a book published a year before by the best-known British economist of that day – Maynard Keynes – on *The General Theory of Employment Interest and Money*, and to the reviews which other economists had given to it.

“I contrasted Keynes’ book with the methods by which Einstein had revolutionized our understanding of one part of physical nature. ‘Einstein started with facts – the Morley Mitcheson [*sic*] measurements of light, the movements of the planet Mercury, the unexplained aberrancies of the moon from its predicted place [*sic*]’ – ‘Einstein went back to facts or told others where they should go, to confirm or reject his theory...’ ‘Mr. Keynes starts, not from any fact, but from the definition of a concept, of what he (Mr. Keynes) means when he says “involuntary

unemployment"... Mr. Keynes does not return to facts for verification. There is no page throughout his work on which a generalization is set against marshalled facts for testing.'

"I turned to the reviewers – three acknowledged leaders among professional economists. Not one of them, I declared, suggested that Keynes' theory should be tested by facts or asked how it compared with facts. 'The distinguishing mark of economic science, as illustrated by this debate, is that it is a science in which verification of generalizations by reference to facts is neglected as irrelevant.' I went on to a famous profession of faith by William Harvey: 'I profess to learn and to teach anatomy, not from books, but from dissections; not from the positions of philosophers, but from the fabric of nature.' In contrast to this, a large part of economic writing today was 'argument from the positions of philosophers – of Ricardo, or Karl Marx or Marshall, or the Austrian School or the Stockholm School' and so on."⁵⁰

One can imagine how Hayek might have felt upon hearing, from his superior, such trenchant and valid public criticism of his dogmatic approach to economic theory, combined with such an inept description of Einstein's theoretical work; and then there was, in the 1940s, the gall of Beveridge suavely *accepting* Keynes's "revolution of economic thought" while implying that his own work of 1909 was of comparable stature:

"The average rate of unemployment in Britain, that is to say the percentage of persons seeking work who could not find it, was between two and three times ... as high between the wars as it had been before the First World War. But doubling or tripling the rate of unemployment means much more than doubling or trebling the misery of unemployment. With unemployment at 5 per cent or less, the bulk of it consists of short-interval unemployment of people who have not been idle long and can hope shortly to return to work. Unemployment at 15 per cent includes many who have been unemployed for long periods and have lost or are losing hope, as well as bodily vigour and the habit of work.... The two approaches to the problem of unemployment in my first study of 1909 and in J. M. Keynes's *General Theory* of 1936 are not contradictory but complementary. The level of unemployment at any time depends, on the one hand, on the demand for the products of industry, and on the other hand, on the manner in which industry responds to the demand. In 1909, I assumed, in accord with all academic economists and most practical men, that, apart from the trade cycle, demand would look after itself. I was concerned mainly with the way in which industry responded to the demand; the results of that study were summed up in its title – *Unemployment: A Problem of Industry*. The revolution of economic thought effected by J. M. Keynes, aided by the experience of the thirties, lies in the fact that adequate demand for labour is no longer taken for granted.... The Keynesian analysis does not deny the importance of disorganization of the labour market as a cause of unemployment. My first study did not deny the possibility of deficiency in total demand for labour."⁵¹

Hayek in later years stooped to telling his American acolytes that Beveridge had been so utterly ignorant of economics that he could never possibly have written such passages, he had got someone else to write the entire book for him, he was sexually impotent, etc.⁵² The passage is from Beveridge's *Full Employment in a Free Society* (1944), which, together with his *Social Insurance and the Allied Services* (the "Beveridge Report," 1942), was rather more ambitious than his famous study of 1909 had been: those books of the 1940s set the stage for the post-war British welfare state – which Hayek tried but failed to prevent by writing *The Road to Serfdom*.

It is true that Beveridge had, in putting together the "Beveridge Report," a great deal of help – not just ideas, but also drafting of text – from an informal committee of four brilliant economists and sociologists: Barbara Wootton, E. F. Schumacher, Joan Robinson and Nicholas Kaldor.⁵³ To place this fact in proper historical context, one has to take into account the historical relations between the "Fabian Society," Sidney and Beatrice Webb, the LSE, and the socio-economic achievements of Great Britain when governed by Labour-Party administrations. The following observations are from a highly respected American history of economic thought:

"The decisive step in the formation of a British kind of democratic socialism was the founding of the Fabian Society in 1884, which was joined shortly thereafter by George Bernard Shaw (1856-1950) and Sidney Webb (1859-1947).... Gradualness was the watchword of the Fabian Society, which derived its name from that of Quintus Fabius Maximus Cunctator, the "delayer," a Roman general known for his holding tactics.... Sidney Webb and his wife Beatrice (1858-1943)... wrote a great number of historical and empirical studies which diverted the discussion of economic problems from ideological concerns and the analysis of abstract concepts and brought it down to the level of facts, and approach rarely practiced in the older universities and for whose promotion Webb founded the London School of Economics in 1895.... After [the] two world wars a large part of the program of the Fabians has become reality in Britain. The welfare state was established and a substantial portion of industry nationalized. All this had been accomplished by democratic means, and the central government, while reaching

out into virtually all spheres of the economy, continued to be bound by the traditional reverence for civil rights and liberties.... The fulfillment of working class aspirations by her own kind of democratic socialism made England immune to communism.”⁵⁴

Hayek’s sense of history is most significantly represented by his statement, addressed to the American people in 1945, that

“[T]he rise of fascism ... was not a reaction against the socialist trends of the preceding period but a necessary outcome of those tendencies.”⁵⁵

Back in 1931 he had believed that all “anti-liberalism” (i.e. all opposition to libertarianism)

“leads inevitably to a reign of universal compulsion, to intolerance and the suppression of intellectual freedom.... Nothing ... would be less justifiable than that the nations of western Europe should look down on the German people because they have fallen victims to [something] which, in this country [Britain], seems a kind of barbarism. What must be realized is that this is only the ultimate and necessary outcome of a process of development in which the other nations have been for a long time steadily following Germany – albeit at a considerable distance.... [T]here seems little prospect that the reversal of these intellectual tendencies elsewhere [besides Germany] will come in time to prevent other countries from following Germany in this last step also.”⁵⁶

He remained for the rest of his life haunted by this vision of socialist tendencies leading inevitably to fascism throughout the West, even though Churchill told him privately that “it will never happen in Britain.”⁵⁷

Soon after *The Road to Serfdom* was published, Keynes sent to Hayek a cordial, 1025-word letter (“My dear Hayek, ... Yours ever, Keynes”) saying that he had found time, while sailing to the USA to attend the Bretton Woods negotiations, to “read your book properly,” and had found it “grand”:

“You will not expect me to accept quite all the economic dicta in it. But morally and philosophically I find myself in agreement with virtually the whole of it; and not only in agreement, but in a deeply moved agreement.”

Keynes remarked that it would have been “in line with your general argument” to point out that

“even if the extreme planners can claim their technique to be the more efficient, nevertheless technical advancement in a less planned economy is so considerable that we do not today require the superfluous sacrifice of liberties which they themselves [in countries like Britain] would admit to have some value.”

He perceived clearly what would later be widely recognized (as noted above) as the “fundamental difficulties” in Hayek’s political philosophy:

“You admit here and there that it is a question of where to draw the line. You agree that the line has to be drawn somewhere, and that the logical extreme is not possible. But you give us no guidance whatever as to where to draw it.... [A]s soon as you admit that the extreme is not possible ... you are, on your own argument, done for, since you are trying to persuade us that so soon as one moves an inch from the planned direction [one is] necessarily launched on the slippery path which will lead in due course over the precipice.”

Keynes believed – and history has shown him to have been correct – that

“Moderate planning will be safe if those carrying it out are rightly orientated in their own minds and hearts to the moral issue.”

He warned Hayek of “the probable failure of the application of your philosophy in the United States in a fairly extreme form,” and concluded that what was really needed (in Britain) was

“a return to proper moral values in our social philosophy. If only you could turn your crusade in that direction you would not look or feel quite so much like a Don Quixote. I accuse you of perhaps confusing a little bit the moral and the material issues. Dangerous acts can be done safely in a community which thinks and feels rightly, which would be the way to hell if they were executed by those who think and feel wrongly.”⁵⁸

For Hayek, however, none of what Keynes called “moral values” were moral at all. For Hayek there were two and only two kinds of valid moral concern. One kind consisted of a set of certain

“rules of human conduct that gradually [in the course of world history] evolved (especially those dealing with several property [he meant property owned by various individuals rather than by a king or temple or village or

tribe], honesty, contract, exchange, trade, competition, gain, and privacy). These rules are handed on by tradition, teaching and imitation, rather than by instinct, and largely consist of prohibitions ('shalt not's').... These rules, in effect constituting a new and different morality, and to which I would indeed prefer to confine the term 'morality', suppress or restrain the 'natural morality', i.e. those instincts that welded together the small group and secured cooperation within it...."⁵⁹

He thus held that "natural morality" (the kinds of behavior advocated by Jesus for instance) is not moral. He felt that the only valid moral precept other than the "shalt not's" described above was one additional prohibition of a different kind in the sense that it was devised by him rather than having evolved gradually in the course of history: not to put into effect any provisions that *he* would consider to be "socialist" – because, he said, they would sooner or later lead inevitably to dictatorship.

His reason for maintaining that none of the traditional moral teachings of the great religions (he was himself an agnostic with no adherence to any religion⁶⁰) are part of morality was that in his opinion, morality in the true sense of the term could be neither instinctive nor rational:

"I prefer to confine the term 'morality' to those non-instinctive rules that enabled mankind to expand into an extended order_[s] since the concept of morals makes sense only by contrast to impulsive and unreflective conduct, on the one hand, and to rational concern with specific results on the other."⁶¹

By excluding instinctive human goodness he disposed of such intuitively sanctioned precepts as the Golden Rule and the second "Great Commandment" of Jesus (to "love thy neighbor as thyself"). By denying that there could be any such thing as rational morality he disposed of (a) government planning for the benefit of society and (b) moral concepts put forth by intellectuals who disagreed with him.

Please judge for yourself whether non-rational, non-instinctive "shalt not's" have, in this age of intense globalization, restrained effectively the suicidal Muslim fundamentalist terrorists, the Chinese hackers, the materially corrupt politicians and bureaucrats in India, the banksters in the USA, the torturers, etc. Hayek himself was morally rudderless in his personal affairs. According to his admiring biographer,

"Hayek left his first wife and [his] children [in London] on December 27, 1949. He flew to New York, where he attended the American Economic Association convention from December 29, 1949, to January 2, 1950. While there, he slipped a note under the door of ...[the] chair of the economics and business department at the University of Arkansas at Fayetteville. (Arkansas had permissive divorce laws.) He wondered whether the department would be interested in him as a visiting professor.... Hayek's divorce was granted on July 13, 1950 in ... Arkansas. He then married Helene Bitterlich in Vienna, before returning to Chicago for the autumn term."⁶²

Hayek admitted (in an interview given later) that the woman who had borne his children, and whom he had managed in Arkansas to discard, "was a very good wife to me":

"[B]ut I wasn't happy in that marriage. She refused to give me a divorce, and I finally enforced it."⁶³

He spent his next dozen years at the University of Chicago. His professorship there was not in the Economics Department (which would not accept him into its faculty: we have already cited Milton Friedman's opinion of him as an economist) but in a deluxe "Committee on Social Thought" where he was funded by outside private sources with a vested interest in libertarian ideology (mainly the Volker Fund,⁶⁴ which did the same for Mises at New York University⁶⁵). He was still, as he had been in London already two decades earlier, a scintillating teacher, enthusiastic and erudite; and it was during his Chicago years that he undertook, in *The Constitution of Liberty*, to provide – let us adapt Keynes's phrase for it – "guidance as to where to draw the line" between wise and foolish governmental tasks.

A basic aspect of Hayek's doctrine in regard to governmental laws was that

"when we obey laws, in the sense of general abstract rules laid down irrespective of their application to us, we are not subject to another man's will and are therefore free.... It is not to be denied that even general, abstract rules, equally applicable to all, may possibly constitute severe restrictions on liberty. But when we reflect on it, we see how very unlikely this is. The chief safeguard is that the rules must apply to those who lay them down and those who apply them – that is, to the government as well as the governed – and that nobody has the power to grant exceptions."⁶⁶

And meanwhile his tepid but consistent endorsement of government doles for very indigent members of affluent societies provided in theory a partial answer to the problem raised by Anatole France's famous remark (in regard to his own homeland in the 1890s) that "The law, in its majestic equality, forbids the rich as well as the poor to sleep under bridges, to beg in the streets, and to steal bread."⁶⁷

Hayek's social philosophy was, in effect, an account of "extended order" in large modern societies. Readers of his philosophy know that "the key to this account is his concept of 'spontaneous order'."⁶⁸ A sympathetic commentator explains:

"Hayek recognizes that his emphasis on [social] orders that are the result of human action but not of human design may be controversial.... Hayek responds by providing a simple example: the formation of footpaths. Before a footpath is formed in a forest, each person traveling through makes his own path. Over time, certain paths become easier to use because they are used more often. Eventually, 'Human movements through the region come to conform to a definite pattern which, although the result of deliberate decisions of many people, has not yet been consciously designed by anyone.'"⁶⁹

The ideological effect on college-level teaching of economics can be illustrated by the following excerpts from the first chapter of a popular American textbook entitled *The Economic Way of Thinking* (implying that there is only one such way). The passage describes allegedly spontaneous order in rush-hour traffic as a metaphor for the modern market. Notice how the author disregards that the main roads used by commuters the USA are normally not due to footpath-development but are planned, designed, built and maintained by government employees, that the drivers normally have government-issued licenses which they have earned by performing satisfactorily in government-designed and administered tests, and that only certain vehicles – approved by the government after due inspection – are allowed to participate:

"When we have long taken something for granted, it's hard even to see what we have grown accustomed to. That's why we rarely notice the existence of order in society and cannot recognize the processes of social cooperation upon which we depend every day. A good way to begin the study of economics, therefore, might be with astonishment at the feats of social cooperation in which we daily engage. Rush-hour traffic is an excellent example.... The dominant characteristic of rush-hour traffic is not jam but movement, which is why people venture into it day after day and almost always reach their destinations.... Thousands of people leave their homes at about eight in the morning, slide into their automobiles, and head for work. They all choose their own routes without any consultation. [This was written before Google Earth etc. were invented.] They have diverse skills, differing attitudes toward risk, and varying degrees of courtesy. As these passenger automobiles in their wide assortment of sizes and shapes enter, move along, and exit from the intersecting corridors of the city's traffic veins and arteries, they are joined by an even more heterogeneous mixture of trucks, buses, motorcycles, and taxicabs. The drivers all pursue their separate objectives, with an almost single-minded devotion to their own interests, not necessarily because they are selfish, but simply because none of them knows anything about the objectives of the others. What each one does know about the others is confined to a few observations about on the position, direction and velocity of a changing handful of vehicles in the immediate environment. To this they add the important assumption that other drivers are about as eager to avoid an accident as they themselves are. There are general rules, of course, that everyone is expected to obey, such as stopping for red lights and staying close to the speed limit. That's about it, however."⁷⁰

This metaphor can yield some insights into the intricate "Socialist Calculation Debate" in the context of which Hayek had come up with his concept of the market as a collaborative mechanism for producing information so impeccable and so completely adequate that no rational planning will ever be needed: (1) On the one hand, anyone can see that since *dishonest* government officials are all too likely to have Palin-type "highways to nowhere" built with the taxpayers' money, successful government planning depends on a modicum of cultural hygiene in regard to corruption. Various circumstances may poison the situation. What if the only alternative to corruption is poverty? Or what if the most exalted teachers exalt single-minded selfishness over instinctive human goodness? (In that case, banksters would (a) trick people into buying unfeasible mortgages, and then (b) trick investors into buying "derivatives" of the resulting bad debts, and then (c) use their economic clout to make the government bail out the people who own the derivatives but not the people whose homes are at stake.) (2) But on the other hand, an ongoing task for rational socialist planners (if they are honest) would be to consider how the roadway systems which they have designed and which have been in use for a while can be improved by modifications and extensions. Tolls could provide relevant market-price-type information. But,

multi-dimensional data as well – showing, for instance, how fast the traffic is moving on the various roadways, how the various lanes are being used by vehicles of various kinds, etc. – could be gathered directly by observation (e.g. by filming from a helicopter). What is the relative value of such “in-kind” data *vis à vis* market prices? Are both kinds of information needed? Is one enough without the other? Hayek said, as we have seen, that freely fluctuating market prices suffice without any other kind of information. (They also – in terms of our metaphor – keep off the roads everyone who cannot afford to pay them.) His socialist opponents in the debate differed; a summary of some of their views is appended to this essay.

Apart from academia, Hayek’s political acolytes in the USA today declare that government programs promoting safety, public health and other aspects of national welfare entail dictatorship, which the Hayekians claim to find morally repugnant. But Hayek’s own stance in regard to dictatorships was equivocal. He said that although he was “totally” opposed to them “as long-term institutions,” there is a moral imperative to instigate them and support them for years on end in order to destroy governmental interference with the impeccable wisdom of the price system. In an interview given in Chile during the eighth year of the extremely brutal military dictatorship there, he declared that “at times it is necessary for a country to have, for a time, some form or other of dictatorial power” and that “as you [in Chile] will understand, it is possible for a dictator to govern in a liberal way.”⁷¹ Mises had expressed in 1927 a somewhat similar view of fascist-type politics:

“It cannot be denied that Fascism and all similar strivings for dictatorship [*Diktaturbestrebungen*] are full of the best intentions and that their intervention has, for the moment, saved European civilization [*Gesittung*]. The merit that Fascism has thereby won for itself will live on eternally in history. Yet the policy which has brought salvation for the moment is not of the kind which could promise lasting adherence to its [own] success. Fascism was a momentary expedient. To view it as something more would be a fateful [*verhängnisvoller*] error.”⁷²

Margaret Thatcher was a great admirer of Hayek:⁷³

“The new Party Leader reached into her briefcase and took out a book. It was Friedrich von Hayek’s *The Constitution of Liberty*. Interrupting, she held the book up for all of us to see. ‘This’, she said sternly, ‘is what we [the Conservative Party] believe’, and banged [the book written by] Hayek down on the table.”⁷⁴

He commended Pinochet’s policies to her for imitation in Britain, but she felt that Britain’s “democratic institutions and the need for a high degree of consent” made “some of the measures” taken by Pinochet “quite unacceptable.”⁷⁵ The British remained, then and since then, no more in a state of servitude than the Swedes – partly because the Iron Lady of the British Conservatives was, unlike Hayek, sufficiently (let us adapt here another phrase from Keynes’s letter cited above) oriented in her mind and heart to the moral issue.

An explanation for the Jekyll/Hyde paradox of Hayek’s theoretical warnings against “serfdom” and practical advocacy of brutal dictatorship can be found in his own psychological precept which he used to explain why Robbins could, upon reflection, disagree with him (as to the remedy for Britain’s economic woes in the 1930s): namely that “economists who serve in government are corrupted as a result” of it. When Hayek made his remarks advocating dictatorship, he was the Honorary Chairman of the Pinochet government’s *Centro de Estudios Públicos*.

That precept of his may well have been due to introspection. A process of corruption by stardom is described inadvertently in the following autobiographical remarks about Hayek’s trip to the USA in 1945:

“[W]hen I arrived in New York [I was told]: ‘The original plan is off. You have suddenly become famous. You go on a lecture tour of the United States.... You start tomorrow morning at Town Hall in New York.’ ... When I was picked up at the Regency Hotel [the next day] and taken downtown, I began to inquire from my chairman, who picked me up, ‘Well, what sort of audience do you expect?’

‘The hall holds three thousand, but there’s overflow.’

‘My God. I have never done such a thing. What am I supposed to lecture on?’

‘Oh, we have called the tune. “Law and International Affairs”.’

‘My God, I have never thought about it. I can’t do this.’

‘Everything is announced. They are waiting for you.’...

So I got up [to talk] on a subject on which I had no idea, and I still know that I began with the sentence, ‘Ladies and gentlemen, I suppose you will all agree with me when I say—’ I didn’t know yet what I was going to say.... [But] gradually I worked them up into great excitement.... I went all over the United States, as far as the mountains and back, and south, for five weeks, and gradually thought I had become quite an experienced public lecturer....”⁷⁶

Upon being awarded his share of the Swedish Bank’s 1974 Nobel Memorial Prize, he observed that

“the Nobel Prize confers on an individual an authority which in economics no man ought to possess.... [T]he influence of the economist that mainly matters is an influence over laymen: politicians, journalists, civil servants and the public generally. [But] there is no reason why a man who has made a distinctive contribution to economic science should be omniscient on all problems of society – as the press tends to treat him till in the end he may himself be persuaded to believe.... [Y]ou ought at least, on conferring the prize, [to] remind the recipient of the sage counsel of one of the great men in our subject, Alfred Marshall, who wrote: ‘Students of social science must fear popular approval: Evil is with them when all men speak well of them.’”⁷⁷

Hayek published in 1979 a treatise, *The Political Order of a Free People*, with proposals for constitutional reforms. In the retrospective survey of his work (mentioned above) published by well-informed libertarians in Zurich in 1994, a diligent reader of this treatise and of Hayek’s other writings has shown⁷⁸ that Hayek advocated not only governmental “assurance of a certain minimum income for everyone,”⁷⁹ but also that government should “distribute its expenditure over time in such a manner that it will step in when private investment flags,”⁸⁰ it should restrict “the sale of ... arms,”⁸¹ and so on and on: the list is so substantial that in the end, “the difference between Hayek and a modern Socialdemocrat boils down to the question whether or not the postal service should be privatized.”⁸² Hayek had said at the outset of his career in England that he would not advocate *laissez faire*,⁸³ and after his migration to the USA (in the wake of the humiliation he helped cause to Churchill in Britain) he would occasionally recall this point⁸⁴ and thus offer a token protest against the ideology of the his rich American patrons. But after becoming an idolized grey eminence he could never *prominently* depart from the ideological slant which had won him his professorships in England and the USA and his fame. This is illustrated clearly in a sanctimonious video (see www.youtube.com/watch?v=52tyPRsL3VQ) entitled “Inside the Hayek Equation: An Interview with Friedrich von Hayek.” (The video demonstrates also a certain degree of intellectual corrosion due to old age.)

Keynes differed notably from Hayek in this regard (do not fear; we will not extol Keynes’s theories) as well as by his consistently decent opposition to dictatorship. And whereas Hayek was, as we have seen, often afflicted with resentment and hatred, Keynes was not. Keynes welcomed criticism, and could openly change his opinions with impunity, because his status was so secure that it did not depend on adhering to dogma. Bertrand Russell called *his* intellect “the sharpest and clearest that I have ever known,” and added: “When I argued with him, I felt that I took my life in my hands, and I seldom emerged without feeling something of a fool”;⁸⁵ he remained intellectually as sharp as a razor down to the end of his life; Virginia Woolf discerned “a kind and even simple heart under that immensely impressive armour of intellect”;⁸⁶ he netted very impressive sums in commercial investments for various businesses and educational foundations and for himself, and enjoyed the satisfactions of philanthropy⁸⁷ (as did Beveridge, who “secretly gave away more than a third of his income to charitable causes, needy relatives, and friends”⁸⁸). Keynes was thus psychologically free to reconsider his academic work of bygone decades in the light of the basic precept of Alfred Marshall, the leading British economist of the previous generation (and his main professor at Cambridge), that “every change in social conditions is likely to require a new development of economic doctrines.”⁸⁹ Keynes incorporated this point of view in a broader explanation as to why it is valid:

“Economics is a science of thinking in terms of models,_[,] joined to the art of choosing models which are relevant to the contemporary world. It is compelled to do this [i.e. to choose *relevant* models] because,_[,] unlike the typical natural science, the material to which it is applied is, in too many respects not homogeneous through time.”⁹⁰

Keynes regarded the model devised in his famous book of 1936⁹¹ as being relevant to conditions in the Great Depression. He pondered raw statistics – as taken in the field – very carefully (but was less interested in graphs because he thought they might conceal as much as they revealed). During and after World War II he was atten-

tive to the dangers of inflation, and Hayek during that period refrained *completely* from criticizing him, because “I wanted to strengthen his influence against the inflationists.”⁹² Apart from all these historical details, however, two broad facts relevant today are that (a) Hayek can serve now in the USA as a smokescreen for class warfare by the very rich against the rest because in his later years he played along with that role (while endorsing social-democratic ideas in the fine print) in order to retain the adulation of his well-heeled supporters, and (b) Hayek’s *and* Keynes’s abstract economic models are in many ways outdated now that human population is four times as big as it was in the 1930s (and increasing absolutely faster than ever before), worldwide per-capita use of natural sources and sinks is likewise far greater (and likewise fast increasing), and yet the Earth is the same old size. Hayek admitted that, as he put it,

“the principle of flood control and the like’s being provided by the government is ... a necessary function of the government”⁹³

and that

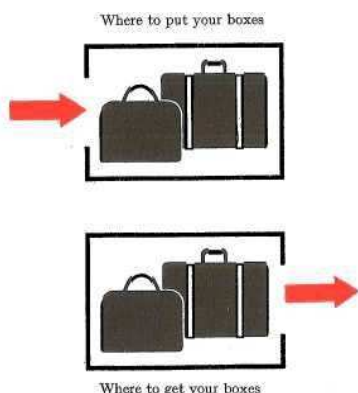
“with the increase in general wealth and of the density of population, the share of all needs that can be satisfied only by collective action will continue to grow.”⁹⁴

But neither he nor Keynes nor Robbins was in a position to know about 21st-century climate change etc. Hayek cried wolf about fascism and “serfdom” materializing in post-war England when there was no wolf at the gate. As long as his ideological influence lasts, his political followers in the USA – many of them sincerely troubled, but some of them just well paid – are likely to use his hate-infected kind of language as they try to persuade us to make, in regard to macro-ecological degradation, the other, even worse mistake in the fable: the one the villagers made when the sentinel was right.

Appendix: Socialist Calculation

Mises initiated the “socialist-calculation debate” in 1920 by arguing that socialism could never be economically efficient, because if government were to own or control the means of production, then planners could not rationally set prices for capital goods (as distinct from consumer goods) since transactions among such goods would in that case become merely “internal” transfers of goods which would thus not be “objects of exchange.” Since the goods would not be priced, planners would be unable to allocate them efficiently, and so, “rational economic activity is impossible in a socialist commonwealth” – whereas the free market with its price system shows how to distribute resources rationally since individuals acting in the market distribute goods and services on the basis of other individuals’ willingness to pay for them: free-market prices convey information about the abundance of resources and their desirability to consumers, whereas socialism, lacking in such a price system, cannot allocate resources rationally.⁹⁵ Hayek developed these points further by (as we have seen) describing the price system under free-market capitalism as an information-processing scheme for which no adequate substitute could be devised. Robbins and Max Weber favored the anti-socialism side of the debate. Oskar Lange (b.1904), Abba Lerner, H. D. Dickinson and, albeit mostly in private discussions, Otto Neurath (b.1882) were on the socialists’ side. This appendix will describe Neurath’s and Lange’s relatively unfamiliar arguments and put them in proper historical context.

Neurath was trained as an economist and became active also as a sociologist, philosopher and graphic designer. His experiences working for the Austrian government during World War I by helping organize the government’s wartime economic planning persuaded him that socialist planning would be feasible and desirable. After the war, the Social Democratic administration in Bavaria invited him to serve on a commission overseeing the socialization of the economy. But then during the 1919 revolution in Germany, the Social Democratic premier of Bavaria was assassinated by right-wing nationalists, and this led to a Communist-led uprising in Munich which resulted in the Social Democratic administration being replaced by a short-lived “Soviet Republic of Bavaria,” which retained Neurath in his post. The German army soon put down the uprising, whereupon he was arrested and charged with treason on account of his having served the soviet republic. He pleaded not guilty on the grounds that his duty as a civil servant had been to serve whoever was in power. Prominent German academics (including Max Weber) spoke out on his behalf, the Austrian government interceded for him, and ultimately his sentence of a year and a half of confinement to a fortress was commuted to expulsion from Germany for seven years.⁹⁶ Returning to his native Austria, he devoted himself to the workers’ movement there (by, for instance, teaching classes for workers). As part of these activities he developed graphic isotypes for conveying practical information to illiterate or semi-literate people⁹⁷ – an invention which had a notable impact on graphic design internationally (see illustrations).



He also resumed his interests in philosophy. Before the war he had been part of a circle concerned with Ernst Mach’s philosophy of science; he was one of several Austrian Marxists drawn to Mach’s philosophy (or, in some cases, to neo-Kantianism) despite Lenin’s disapproval⁹⁸ of such tendencies; now in the 1920s he began to collaborate with a number of philosophers and scientists (Rudolf Carnap, Moritz Schlick, Philipp Frank etc.) in an effort to update Mach’s ideas in light of the new developments in logic that had been pioneered by people like Gottlob Frege, Bertrand Russell and Ludwig Wittgenstein. This new philosophy became known as logical positivism or logical empiricism. Neurath co-authored with Carnap a manifesto for it, “The Scientific Conception of the World: The Vienna



Circle,” and was the driving force behind a unity-of-science movement seeking to join the natural and the social sciences and producing the Vienna Circle’s *International Encyclopedia of Unified Science*.

Much of Neurath’s discussion with Hayek as to the feasibility of socialist calculation hinged on their opposing stances in regard to Neurath’s “physicalism.” Many of the logical positivists envisaged a kind of reconstruction of science on the basis of sense data, but Neurath regarded perceptual experiences as too subjective to provide a valid foundation for science; he thought that a stronger one could be based on mathematically formulated physics and objective spatio-temporal coordinates, and that such an approach would foster the elimination of metaphysical statements from science by enabling its propositions to be reduced to a set of assertions related to physical facts. He held that this physicalism was applicable to the social as well as to the natural sciences.

Until fairly recently, his role in the socialist-calculation debate has tended to be downplayed in literature about the debate, most likely because he communicated with Hayek by post rather than publicly. In recent years, however, research on ecological economics and sustainable development has fostered a revival of interest in some of his economic ideas because he advocated “in-kind” (as distinguished from monetary) economic accounting (*Naturalrechnung*).⁹⁹ (In the 1920s he also advocated *Vollsozialisierung*, i.e. “complete” rather than merely partial “socialization.”) His proposed changes to the economic system were therefore more radical than those advocated by the mainstream Social-Democratic parties of Germany and Austria, and he debated these matters in the '20s with leading Social-Democratic theoreticians (such as Karl Kautsky, who insisted upon the necessity of money in a socialist economy).¹⁰⁰ It was while serving as a government economist during the war that he had observed that

“As a result of the war, in-kind calculus was applied more often and more systematically than before.... It was all too apparent that war was fought with ammunition and with the supply of food, not with money”

—and had come to believe in the feasibility of an economic system with planning done in terms of quantitative amounts of specified goods and services, and with no use at all for monetary currency.¹⁰¹ (It was in response to these ideas that Mises wrote his famous essay of 1920.) For Neurath, war economies displayed advantages in regard to speed of decision and execution, optimal distribution of means relative to (military) goals, and no-nonsense evaluation and utilization of inventiveness. Two disadvantages which he perceived as resulting from centralized decision-making were a reduction in productivity and a loss of the benefits of simple economic exchanges; but he thought (as did Lenin) that the reduction in productivity could be mitigated by means of “scientific” techniques based on analysis of work-flows etc. as advocated by Frederick Winslow Taylor (an American mechanical engineer and management consultant).¹⁰² Neurath believed that socio-economic theory and scientific methods could be applied together in contemporary practice.

Although he was opposed to “market socialism” (as well as to capitalism), he believed in granting some degree of independence to small producers in the crafts and in agriculture:

“The doctrine that there is a trend towards ever more comprehensive organizations has been confirmed fully, less so the doctrine that small businesses will be replaced by large-scale concerns.”¹⁰³

He considered it essential, however, that small producers of various sorts be organized in a multitude of regional and branch organizations to ensure that goods and services would be produced according to a central plan, and he held that “total socialization” would require a comprehensive statistical apparatus:

“Even before they begin their work, all bodies ... should be required to report to the Central Economic Administration, which, in collaboration with the Center for Statistics ... will fit the individual results into the universal statistics.”¹⁰⁴

When countering the theories of some of the leading Austrian champions of market economics (Carl Menger and Joseph Schumpeter), Neurath found that he had to challenge some of their basic assumptions. From Aristotle and from socialist literature he adopted the radical notion of wealth as based on use-value and welfare, whereby economic theory would be concerned with “wealth” in the sense of people’s physical and social conditions. His concept of welfare was, however, more Epicurean than Aristotelian; he said that “social Epicureanism”

“deals with the happiness of human beings as an effect of social actions. What is the effect of different orders of life, of different measures, on the conditions of life of human beings and thereby on their happiness and unhappiness?”¹⁰⁵

He felt that economists should try to find out which conditions promote people’s wealth in that sense of the term, and which institutions increase or decrease it.¹⁰⁶ But he also perceived a theoretical challenge in regard to representing wealth and its allocation in such terms – namely, how to defend the rationality, objectivity and fairness of decision-making in the alternative framework. In considering “the problem of pleasure maximum,” he argued that cardinal measures – that is, quantitative ratings with cardinal numbers (such as, say, 481, 25¾ and 7,333) as distinct from ordinal numbers (1st, 2nd, 3rd...) – for comparative utility or “pleasure values” could not be computed for any one individual, much less for different individuals.¹⁰⁷ He also rejected the assumption that it is possible to sum together the utility functions (the pleasures) of separate individuals. He therefore concluded that it is not possible to calculate maximum social-utility functions, i.e., that interpersonal comparisons of utility are impossible – and likewise for comparisons of utility for the same person at different times.

Neurath felt that this *general* absence of valid unitary measures and algorithms for decision-making weakened the theoretical case for a market economy, because he held that market-economic theory assumes a framework in which “people influence each other’s actions exclusively by means of the higher and lower qualities of life that result from the process of exchange,” with the main conditioning-factors being profit and loss (and with the goals being those of maximizing the one and minimizing the other). On the other hand he thought it would be a virtue of an administrated economy that

[it could,] by rewards and penalties, prompt the individuals to do things which they would not have done in an economy characterized by exchange, because without these rewards and penalties the consequences would have been different.¹⁰⁸

It was a quarter-century after the original exchanges between Neurath and Mises that the debate resumed – this time between Neurath and Hayek but with Neurath’s part of it being kept private by Hayek’s refusal to debate publicly. Neurath, upon reading in 1945 an essay by Hayek which attacked what Hayek called “scientism” and which singled out Neurath as a prime culprit, challenged Hayek to a public exchange of views. Hayek replied:

“I am at the moment entirely engrossed in an attempt to elaborate the psychological implications of the earlier part of my Scientism essays – or rather an attempt to restate certain ideas I had formed on this subject a very long time ago – at the moment at any rate I feel quite unable to give my mind to anything but these questions, but, of course, nothing may come of it.”

(In citing this letter of Hayek’s, an admiring disciple of his has pointed out that he “did not tell Neurath that his new work was aimed at least in part at Neurath’s own physicalism.”¹⁰⁹) However, Neurath persisted with additional correspondence, and the result was a discussion of some of their respective views. Hayek had previously criticized what he saw as Neurath’s rationalism; Neurath responded now that he was just as critical of rationalism as Hayek was and that they actually shared some assumptions as to the limits of reason and predictability. Neurath was rebutting what he saw as some misunderstandings of logical empiricism which were (and still are) widely accepted and which Hayek himself had popularized. Neurath attempted to turn these assumptions back against Hayek in order to defend the possibility of socialist planning. It seemed to Hayek that Neurath’s belief in *in-natura* calculation was due to an illusion as to the nature of knowledge similar to the illusion of social engineers who think social problems have purely technical “optimum” solutions. Hayek thought that social engineers (including Neurath) were falling for a “Cartesian rationalism” which viewed human reason as omnipotent and that they were thus failing to perceive that knowledge, including practical knowledge in the form of local skills and know-how (Michael Polyani had called it “tacit knowledge”), is *dispersed* in society and cannot be articulated in propositional form and gathered together by a central planning agency. Hayek, seeing in the market-price system an indispensable way of coordinating information and distributing it among different economic actors, felt that there could never be an *in-natura* alternative to this reliance on money and prices, there could never be any physical units (such as units of energy) which economic planners could successfully use to devise a uniquely “optimum” solution. However, Neurath himself rejected the notion that there are technocratically based optimum solutions to social problems; he was just as hostile towards technocracy as Hayek; he said that when it comes to social choices, no proposal can be valid unless it takes into account *multiple criteria* (not just monetary price) for evaluation.¹¹⁰ He shared with Hayek certain epistemic assumptions, and his critique of what he called “pseudorationalism” resembled Hayek’s rejection of rational science. So he thought that he could in a public debate turn the tables on Hayek.¹¹¹ But then he died within five months (at the age of 63), and since Hayek had rejected his proposal of a proper debate in public, quite a few issues in their truncated private discussion were left hanging in the air. According to a recent student of Neurath’s philosophy,

“The most striking area in which there is congruence between Hayek and Neurath is in their common rejection of Cartesian rationalism and the technocratic conception of planning that they both take to stem from it. Hayek’s account of Neurath as an advocate of such rationalism in his scientism essay is simply in error. Moreover, there are important overlaps in their arguments against the possibility of complete predictability in the social sciences. For example, both appeal to the argument that complete prediction of the future direction of society is impossible, since social change is dependent on developments in the content of knowledge and those developments are in principle unpredictable.”¹¹²

The extant traces of this private debate do not show whether Neurath in the 1940s was still calling for centrally planned *Vollsozialisierung* (although they do show that Hayek took this for granted). Neurath clearly still doubted,

however, free markets could be relied upon to deal decently with issues involving nonrenewable resources. It is possible to agree with Neurath on that score – and indeed this point has been taken up by modern ecological economists¹¹³ – without accepting his belief (at least in the 1920s) in the feasibility of an economic system so thoroughly permeated with *in-natura* calculations that money could be dispensed with altogether.

The most notable other representative of the Socialist side in the social-calculation debate was Oskar Lange, an explicit opponent of *Vollsozialisierung* in the foreseeable future. (Karl Marx himself had held that only in a distant future could society “inscribe on its banners: ‘From each according to his ability, to each according to his needs!’”¹¹⁴) Lange was a Polish economist who migrated to England in 1934 (subsidized by a Rockefeller fellowship) and then served as an economics professor at the University of Chicago from 1938 to 1945, when he gave up his American citizenship and returned home to Poland. During the war he had worked initially for the Polish government in exile but then had broken with them to work for the Soviet-backed Lublin Committee instead.¹¹⁵ He was a Marxist *and* a neoclassical economist, however. He thought Marxism provided the key to understanding the historical evolution of capitalism (including its supposed ultimate displacement by socialism), but he regarded traditional Marxist economics as inadequate in several ways. He considered the “labor theory of value” (as shared to a great extent by Adam Smith and David Ricardo as well as Marx) unscientific, and held that a Marxian concept of exploitation could be restated without it. He made statements like

“If people want to anticipate the development of Capitalism over a long period, a knowledge of Marx is a much more effective starting point than a knowledge of [Friedrich von] Wieser, [Eugen von] Bohm-Bawerk, Vilfredo Pareto or even [Alfred] Marshall (although the last-named is in this respect much superior). But Marxian economics would be a poor basis for running a central bank or anticipating the effects of a change in the rate of discount.”

and

“[I]n providing a scientific basis for the current administration of the capitalist economy ‘bourgeois’ economics has developed a theory of equilibrium which can also serve as a basis for the current administration of a socialist economy. It is obvious that Marshallian economics offers more for the current administration of the economic system of Soviet Russia than Marxian economics does, though the latter is surely the more effective basis for anticipating the future of capitalism.”¹¹⁶

(He appreciated Marshall for taking seriously the fact that the theoretical concept of “perfect competition” is unrealistic.¹¹⁷ Keynes was also among the non-Marxian economists whom he regarded as very informative about the dynamics of capitalism.¹¹⁸)

Lange held that Mises’s original argument floundered on a confusion over the nature of prices. The concept of price-ratio could, according to Lange, mean not only the exchange-ratio between two commodities in the market, but also, more generally, the “terms on which alternatives are offered”; and he contended that only price ratios in this more generalized sense are indispensable for achieving a rational allocation of resources. In a centrally planned socialist economy, there would be no price ratios in the narrower sense among capital goods, but this would not, he said, preclude the existence of such ratios in the more general sense, because central planners and administrators would have access to the same knowledge of production-functions that is available to capitalist entrepreneurs, and could thus manage to make rational economic decisions.¹¹⁹

Lange regarded Hayek and Robbins as offering a more sophisticated and stronger version (than Mises) of the argument against the feasibility of socialist economic calculation. He interpreted them as conceding the theoretical possibility of a rational allocation of resources in a socialist economy but as arguing that such an allocation was not realizable in practice under socialism. (Hayek thought that any central planning board would have to solve many thousands of equations in order to allocate resources; Robbins said it would entail millions of equations; the general idea dates back to Pareto quite early in the 20th century.¹²⁰) Lange acknowledged that capitalist economies are able to solve the problem of allocating resources rationally via trial-and-error processes (Leon Walras had called them *tâtonnements*¹²¹) in which capitalists adjust prices up or down until markets clear, and that price changes will then act as signals to tell other capitalists whether to increase or decrease the production of given goods or services. He said that in a centrally planned socialist economy, the functions which are performed by the price system would have to be duplicated somehow by the central planners. He believed that they could do it by using a trial-and-error procedure “to determine accounting-prices of capital goods and of productive resources in public ownership”: the planners would adjust prices up or down depending on whether shortages or surpluses had appeared. (They would, for instance, reduce the prices of overstocked elements.)

In an essay published in 1936, Lange discussed various models which a socialist economy might conceivably follow, including some with full freedom for consumer-choices and occupational choices, as well as some where those kinds of freedom would be restricted or even eliminated. He tried to demonstrate that in all those cases, central planners could solve the problem of achieving (a) consistency of decisions and (b) efficiency in carrying them out, and could thus allocate resources rationally. He went on to make it clear that he did not advocate a socialist model in which bureaucrats suspend freedom of choice for consumers and workers in order to impose their own preference-scales on people. He said: “Mr. [Abba] Lerner has sufficiently shown the undemocratic character of such a system and its incompatibility with the ideals of the socialist movement.”¹²² A year later he pointed out that

“As [Cambridge] Professor [A.C.] Pigou has shown,¹²³ there is frequently a divergence between the private cost borne by an entrepreneur and the social cost of production. In the cost account of the private entrepreneur, only those items enter for which he has to pay a [monetary] price [to someone else], while such items as the maintenance of the unemployed created when he discharges workers, the provision for the victims of occupational diseases and industrial accidents, etc., do not enter.... [Under capitalism, certain important matters, such as the] life, security, and health of the workers, are sacrificed without being accounted for as a cost of production. A socialist economy would be able to put all the alternatives into its [in-kind]economic accounting.... By doing so it would avoid much of the social waste connected with private enterprise. As Professor Pigou has shown, much of this waste can be removed by proper legislation, taxation, and bounties within the framework of the present economic system; but a socialist economy can do it with greater thoroughness.”¹²⁴

Hayek’s rejoinder (1940) began with the argument (which he said Pareto had hinted at) that socialist economic planning would be unfeasible because the planners would have to solve too many simultaneous equations; then he turned to Lange and his allies (mentioning Dickinson) and, after berating them for allegedly not admitting that their proposals for socialist economic planning differed from previous ones which socialists and critics of socialism had been discussing, expressed doubt as to the efficiency of having a central authority adjust prices by trial and error. He was convinced that no central authority could reset prices in a timely manner; at best it would be, he said, much slower than market forces at adjusting them in relation to supply and demand. He added that people like Lange and Dickinson, overly concerned with the issue of whether or not a socialist economy could duplicate the results achieved by a market economy under conditions of perfect competition, ignored the fact that capital goods in heavy industry (buildings, ships, machinery etc.) are usually produced to meet special contracts rather than for open markets; vendors might compete to win the contracts, but seldom under conditions resembling perfect competition as envisioned by neoclassical economists. No central planning authority could, he said, be relied upon to set prices properly in such peculiar situations.¹²⁵

Lange acknowledged promptly in a letter to Hayek that this article made some important points. He saw Hayek as having shifted considerations of the socialist-calculation problem from a “static” to a “dynamic” standpoint. Lange said that even though sensible prices could in theory be determined by trial and error in the absence of a market, in practice he favored the determination of prices by markets wherever this was feasible – which for him meant wherever there were sufficiently large numbers of both purchasers and sellers – but that prices should be set by public agencies in those sectors of the economy where the numbers of sellers or purchasers are low. He held that something analogous happens under capitalism, except that *there* it is monopolies which do the price-fixing rather than agencies acting in behalf of public interest.¹²⁶

Hayek responded in 1945 in a paper, “The Use of Knowledge in Society,” which is nowadays remembered less for its repeated arguments against Lange than for the one about diffused knowledge which we have cited in the main part of this essay. Hayek held that the trial-and-error method of planning proposed by Lange could never produce a rational allocation of resources because there could never be any way for national planners to gather together enough valid information. In *The Road to Serfdom* he argued that one reason why, if the Labour Party were to win the election of 1945, life in Great Britain would amount to serfdom, was that

“[it is] impossible to assume control over all the productive resources without also deciding for whom and by whom they are to be used. Although under this so-called ‘competitive socialism’ the planning by the central authority would take somewhat more roundabout forms, its effects would not be fundamentally different, and the element of competition would be little more than a sham.”¹²⁷

In the 1960s Lange argued, in an essay entitled “The Computer and the Market,” that recent technological developments made it possible to solve in relatively short periods of time the large sets of equations theoretically involved in certain aspects of rational central planning.¹²⁸ This did not change his basic view that planners would always have to correct their plans by the trial and error. He said that some economic processes are so complicated that it

would still be impossible to construct good computerized models of them, and he observed that markets were already being used in socialist economies for the distribution of consumer goods; yet he argued that computers give faster answers than markets do, and that market-price changes cause different social groups to experience either increases or decreases in their incomes (with results that would be problematic in a socialist economy where there is supposed to be a policy of evening out the incomes) and indeed that markets sometimes fail to provide iterative solutions to the equations – that is, they do not always converge to equilibrium, there may instead be “cobweb-cycles” (inventory- or other reinvestment-cycles) as well as more general business-cycles. He felt that while computers could be used for making prognostications, (a) it would be unwise to try to replace markets altogether in regard to short-term decisions; economic planners could instead use sophisticated computer models to make forecasts which would then be verified against market data; whereas (b) markets are not very useful for long-term economic planning since they work by treating the accounting problem as a static issue. He was alert to the fact that prices reflect recent conditions but do not provide systematic information as to the possible effects of investment changes, of changes in technical conditions for production, and of the creation of new wants. Such shortcomings in the informative value of market prices were, in his opinion, present under capitalism as well as under socialism.

Hayek never replied to these arguments.

We should perhaps mention that the substance of much of the debate between Lange and Hayek was reviewed in Part III (“Can Socialism Work?”) of Joseph Schumpeter’s monumental *Capitalism, Socialism and Democracy* (1942). Schumpeter believed that economic depressions are like invigorating “cold showers” promoting entrepreneurial and technological innovation, but he also believed that capitalism is less likely to last indefinitely than to be succeeded by socialism.

For an assessment of Lange as a political figure (and not just as an academic theorist of economics) it would be of interest to consider his relationship with the Communist government of Poland. A detailed assessment is beyond our scope,¹²⁹ but we may observe that after he had served in 1944 as an emissary between Roosevelt and Stalin as to the future of Poland, and in 1945-46 as Poland’s ambassador to the USA, and then for a while as her representative to the United Nations, he was recalled home and shunted into an academic position in 1949 when Stalinist orthodoxy was imposed in Poland. And yet when Stalin died (in 1953) he published an article eulogizing him as an economic theorist. This has damaged his reputation, somewhat as Hayek’s adulation of the Pinochet regime in Chile¹³⁰ and Mises’s declaration that “the merit which Fascism has ... won for itself will live on eternally in history”¹³¹ have damaged theirs; but there are some significant differences inasmuch as Mises and Hayek were championing the use of brutality (and Hayek even said that he wished it to be used elsewhere in Latin America as well as in Chile) whereas Lange was opposing it. While displaying a disgusting obsequiousness toward Stalin (or rather, toward the powerful Stalinists in Poland), he was actually using citations from Stalin in order to advocate moderation. His concluding paragraphs are full of statements in the following vein:

“Stalin’s establishment of the objectivity of economic laws under conditions of socialism ... does nothing to lessen the socialist state’s active and creative role. It serves as a warning against any reckless policy which would discount the necessities imposed upon the state by objective reality, on the assumption that ‘Soviet government can ‘do anything’, that ‘nothing is beyond it’, that it can abolish scientific laws and form new ones’. Such a policy is sterile; it will fail to reach its objectives and will provoke violent reactions....

“Both [a] economic recklessness which ignores objective laws and [b] fetishism which abjectly surrenders to such laws constitute deviation from [correct] socialist policy. Both lead to the same result, namely, to the return of violence in economic processes. Correct socialist policy is based on an understanding of objective economic laws and on their appropriate exploration towards the attainment of chosen ends. For instance, with regard to the law of value, Stalin says, ‘The trouble is not that production in our country is influenced by the law of value. The trouble is that our business executives and planners, with few exceptions, are poorly acquainted with the operations of the law of value, do not study them, and are unable to take account of them in their computations.’ This is why it is necessary for a correct and effective socialist polity to be based on scientific knowledge and on the scientific principles of the political economy of socialism.

“The founding of policy upon a deeper scientific acquaintance with economic laws strengthens the active as well as creative role of the socialist state. It thereby acquires means which increase the effectiveness of its activities and add to its vigor and power. This is a source of strength to the state which is not and cannot ever be available to any capitalist state.... The capitalist state is powerless to overcome crises and other contradictions and becomes helpless in the face of the disintegration of the system....

“Knowledge of the economic laws of socialism, for which we are indebted to Stalin, opens new vistas and points to further possibilities of the creative shaping by man of his social evolution.”

When public protest against the government broke out three years later, he took the opportunity to outline publicly a set of proposed reforms, which were, according to a leading government spokesman, “neither implemented nor rejected.”¹³² He was accorded a prestigious title – “Deputy Chairman” of the “Council of State” – for the last four years of his life (he died in 1965); and, *some* reforms were eventually carried out; but by 1989 the Communist regime would eventually fall under pressure from *Solidarność*.

In those days it seemed clear to many thoughtful economists (not just libertarian ideologues) that since “real existing socialism” was collapsing, capitalism would remain the wave of the future for the 21st century as it had been for the 19th and 20th. But after economic conditions in Poland then proceeded to deteriorate for a very considerable part of the population,¹³³ and the outcome in Russia was even worse (conditions *there* deteriorated so much that “age-adjusted mortality ... rose by almost 33% between 1990 and 1994” according to the American Medical Association¹³⁴), and then the free market gave us financial collapse of 2007-08 and the debilitation of the great American dream, it began to seem, from a 21st-century perspective, that the libertarians are just as guilty of ideological excess – stressing pet ideas to an unhealthy extent – as the most dogmatic of the Communists were. The socialist-calculation debate of 1920-65 is now a superannuated relic of history. Fresh thinking now should be free to draw insights from it, but free as well of its ideological excesses and alert to differences between the 20th- and 21st-century conditions of humankind.

We extend warm thanks to Prof. Jan Otto Andersson and Dr. Ralf Eriksson (Åbo Academy University), Prof. Tadeuz Kowalik (Polish Academy of Sciences), Prof. Pulin Nayak (Delhi School of Economics) and Dr. Chris Sciabarra (New York University) for suggesting improvements to earlier drafts of this essay. None of them has seen the final draft; we alone are responsible for it.

Notes:

(Where two dates are given for a book, one of them is for the first edition and the other one is for the edition cited in the note.)

1. See <http://hayekcenter.org/?p=2719>.
2. Robert Skidelsky, *John Maynard Keynes, 1883-1946. Economist, Philosopher, Statesman* (2003), 833.
3. Hayek, *Law, Legislation and Liberty* (1973-79 in 3 vols., the 2nd of which is entitled *The Mirage of Social Justice*).
4. Hayek, ed. S. Kresge and L. Wenar, *Hayek on Hayek: An Autobiographical Dialogue* (1994), 118.
5. Hayek, ed. B. Caldwell, *The Road to Serfdom. Texts and Documents* (2007), 148; *Op. cit.* in Note 4, 112.
6. Hayek, ed. J. T. Salerno, *Prices and Production and Other Works: F. A. Hayek on Money, the Business Cycle, and the Gold Standard* (2008), 237.
7. *Ibid.*, 315.
8. Richard Ferdinand Kahn, *The Making of Keynes's General Theory* (1984), 182.
9. *The Collected Writings of John Maynard Keynes* (30 volumes, 1972-89), VI, 132-33.
10. *Op. cit.* in Note 9, XXVII, 389.
11. *Op. cit.* in Note 6, 113-14.
12. Kari Polyani-Levitt and Martuerite Mendell, "The Origins of Market Fetishism," *Monthly Review*, XLI (June 1989), 11-32.
13. Lionel Robbins, *Autobiography of an Economist* (1971), 131-32, 153-54.
14. *Op. cit.* in Note 4, 148.
15. Alan O. Ebenstein, *Friedrich Hayek: A Biography* (2001), 273.
16. *Op. cit.* in Note 4, 94.
17. D.P. O'Brien, *Lionel Robbins* (1988), 135.
18. Piero Sraffa, "Dr Hayek on Money and Capital," *Economics Journal* XLVII (1932); John R. Hicks, "Equilibrium and the Cycle," *Economics Journal* XLVIII (1933); Frank H. Knight, "Capitalistic Production, Time and the Rate of Return," in *Economic Essays in Honor of Gustav Cassel* (1933); Gunnar Myrdal, *Monetary Equilibrium* (1939; revised English version of "Der Gleichgewichtsbegriff als Instrument der Geldtheoretischen Analyse," in Hayek, ed., *Beiträge zur Geldtheorie*, 1933), 38-40, 106-07, etc.
19. Bruce Caldwell, *Hayek's Challenge. An Intellectual Biography of F. A. Hayek* (2004), 180; Hayek, *The Pure Theory of Capital* (1941), vii-viii.
20. *The Economic Writings of Sir William Petty*, ed. C.H. Hull (1899), I, 44
21. Mises, "Die Wirtschaftsrechnung sozialistischen Gemeinwesen," *Archiv für Sozialwissenschaft und Sozialpolitik*, XLVII (1920), 99.
22. Hayek, "The Use of Knowledge in Society," *American Economic Review*, XXXV (1945), 520 and 524-25.
23. Harold Hotelling, "The Economics of Exhaustible Resources," *Journal of Political Economy*, XXXIX (1931).
24. Lester Thurow, *The Future of Capitalism* (1996, 1997), 268.
25. Michael Straight, *After Long Silence* (1983), 67.
26. Ian Jarvie and Sandra Pralong, ed., *Popper's Open Society after Fifty Years: The Continuing Relevance of Karl Popper* (1999), 92.
27. *Op. cit.* in Note 13, 106-07.
28. Harold Macmillan, *The Middle Way: A Study of the Problem of Economic and Social Progress in a Free and Democratic Society* (1938), 66.
29. *Ibid.*, 102.
30. *Ibid.*, 348
31. *Ibid.*, 356-57

32. *Op. cit.* in Note 9, ix, 311.
33. Caldwell, *op. cit.* in Note 19, 347.
34. *Routledge Encyclopedia of Philosophy* (1998), s.v. “Hayek, Friedrich August von (1899-1992),” § 3.
35. Hayek, “The Intellectuals and Socialism,” *The University of Chicago Law Review*, xvi (1949) , 420.
36. Hayek, ed. W. W. Bartley III, *The Fatal Conceit: The Errors of Socialism* (1988), 36-37.
37. *Op. cit.* in Note 4, 148-49.
38. *Op. cit.* in Note 9, ix, 326.
39. Citizens for Tax Justice, “America’s Tax System is Not as Progressive as You Think,” at www.ctj.org/pdf/taxday2011.pdf (2011).
40. Christoph Frei and Robert Nef, ed., *Contending with Hayek: On Liberalism, Spontaneous Order and the Post-Communist Societies in Transition* (1994).
41. William J. Barber, *Gunnar Myrdal. An Intellectual Biography* (Palgrave “Great Thinkers in Economics” series, 2008).
42. *Winston S. Churchill: His Complete Speeches, 1897-1963* (8 vols. in one continuous pagination, 1974), 7172.
43. *Op. cit.* in Note 41, 165.
44. *Op. cit.* in Note 4, 84.
45. Appian of Alexandria, tr. H. White, *Roman History* (1912), §§128-29.
46. *Dictionary of National Biography* (UK), s.v. “Beveridge, William Henry, Baron Beveridge (1879-1963).”
47. *Op. cit.* in Note 40, 284-87.
48. José Harris, *William Beveridge: A Biography* (1977), 284.
49. *Op. cit.* in Note 46, 20.
50. Beveridge, *The London School of Economics and its Problems 1919-1937* (1960), 94-95.
51. Beveridge, *Full Employment in a Free Society* (1944), 107; cited in K. and J. Williams, ed., *A Beveridge Reader* (1987), 133-34.
52. *Op. cit.* in Note 4, 85-86.
53. Caldwell, *op. cit.* in Note 19, 175.
54. Henry William Spiegel, *The Growth of Economic Thought* (revised and expanded edition, 1983), 499-502
55. Hayek, ed. M. Eastman, *The Road to Serfdom* (Readers Digest version, 1945), 31-32.
56. *Op. cit.* in Note 5, 245.
57. *Op. cit.* in Note 4, 106.
58. *Op. cit.* in Note 9, xxvii, 385-88.
59. *Op. cit.* in Note 36, 12.
60. Hayek, interview published in *El Mercurio*, Santiago de Chile (12 April 1981), D9.
61. *Op. cit.* in Note 36, 12.
62. *EH*, 168-69
63. *Loc. cit.*
64. *Op. cit.* in Note 15, 175.
65. *Ludwig von Mises, Notes and Recollections* (1978), 155.
66. Hayek, *The Constitution of Liberty* (1960), 153-55.
67. Anatole France, *The Red Lily* (1894) , Ch.7.
68. *Op. cit.* in Note 34, §2, ¶8

69. Caldwell, *op. cit.* in Note 19, 246; Hayek, *The Counter-Revolution of Science: Studies on the Abuse of Reason* (1952, 1979), 70-71.
70. Paul Heyne, *The Economic Way of Thinking* (1973 and later editions), Ch.1, ¶¶2-5
71. *Loc. cit.*, in Note 59.
72. Mises, *Liberalismus* (1927), 45.
73. Margaret Thatcher, *The Path to Power* (1995), 50 and 84-85.
74. John Ranelagh, *Thatcher's People: An Insider's Account of the Politics, the Power, and the Personalities* (1991), ix.
75. Greg Grandin, *Empire's Workshop. Latin America, the United States, and the New Imperialism* (2006), 172.
76. *Op. cit.*, in Note 4, 104-05.
77. Hayek, banquet speech, 1974; see www.nobelprize.org/nobel_prizes/economics/laureates/1974/hayek-speech.html.
78. *Op. cit.* in Note 40, 128-29.
79. *Op. cit.* in Note 3, III, 44.
80. *Ibid.*, 59.
81. *Ibid.*, 62.
82. *Op. cit.* in Note 40, 130.
83. Hayek, "The Trend of Economic Thinking," *Economica*, XIII/2 (1933).
84. E.g. Hayek, *The Constitution of Liberty* (1960), 231.
85. Bertrand Russell, *Autobiography* (1967-69 in 3 vols., 1978 in 1), 69.
86. Virginia Woolf, *Moments of Being* (1976, 1985) , 198.
87. *Op. cit.* in Note 2, 519-23.
88. *Loc. cit.* in Note 46.
89. Alfred Marshall, *Principles of Economics* (1890, 1920), 37.
90. *Op. cit.* in Note 9, XIV, 297.
91. Keynes, *The General Theory of Employment, Interest and Money* (1936).
92. *Op. cit.* in Note 4, 91.
93. *Op. cit.* in Note 4, 113.
94. *Op. cit.* in Note 3, III, 53.
95. *Op. cit.* in Note 21.
96. A. J. Ayer, "The Vienna Circle," in his *Freedom and Morality and Other Essays* (1984), 159-177.
97. Neurath, *International Picture Language* (1936, 1980).
98. Vladimir Lenin, *Materialism and Empirio-Criticism: Critical Comments on a Reactionary Philosophy* (1909).
99. John O'Neill, "Socialist Calculation and Environmental Valuation: Money, Markets and Ecology," *Science & Society*, LXVI/1 (Spring 2002); Joan Martinez-Alier and Klaus Schlupmann, *Ecological Economics: Energy, Environment, and Society* (1987), 212-218.
100. Günther Chaloupek, "Otto Neurath's Concepts of Socialization and Economic Calculation and his Socialist Critics" (2006), at www.chaloupek.eu/work/NeurathFin.pdf.
101. Otto Neurath, ed. T. Uebel and R. S. Cohen, *Economic Writings* (2004), 304.
102. *Ibid.*, 378-79.
103. *Ibid.*, 387-88.
104. *Ibid.*, 389.
105. *Ibid.*, 415.

106. *Ibid.*, 328.
107. Neurath, *Empiricism and Sociology* (1973), ??
108. *Op. cit.* in Note 100, 321.
109. Caldwell, *op. cit.* in Note 19, 257.
110. Neurath "Physicalism, Planning and the Social Sciences: Bricks Prepared for a Discussion v. Hayek," in the Otto-Neurath *Nachlass* (archive of his private papers) in Haarlem, 202, K56.
111. *Op. cit.* in Note 100, 549-550.
112. John O'Neill, "Knowledge, Planning, and Markets: A Missing Chapter in the Socialist Calculation Debates," *Economics and Philosophy*, XXII (2006), 55-78.
113. Martinez-Alier and Schlupmann, *op. cit.* in Note 5; Mathis Wackernagel, "Why Sustainability Analysis Must Include Biophysical Assessments," *Ecological Economics*, XXIX, 13-15; Herman E. Daly and Joshua Farley, *Ecological Economics : Principles and Applications* (2nd edition, 2010), Chapter 11, "Market Failures and Abiotic Resources," and Chapter 12, "Market Failures and Biotic Resources"; etc.
114. See www.marxists.org/archive/marx/works/1875/gotha/ch01.htm.
115. Tadeusz Kowalik, "Introduction" to Oskar Lange (ed. T. Kowalik), *Economic Theory and Market Socialism: Selected Essays* (1994) , ix-xxv.
116. Lange, *op. cit.* in Note 115, 5-6.
117. Marshall, *Principles of Economics* (9th edition, 1961), 772-73, 781, 850, *et passim*.
118. Lange, *op. cit.* in Note 115, 189-212.
119. *Ibid.*, 252-255.
120. *Ibid.*, 266. Hayek, *Collectivist Economic Planning* (1935), 212. Robbins, *The Great Depression* (1934), 151. Pareto, *Les systèmes socialistes*. Vol. II (1903), 289-290.
121. Léon Walras, *Éléments d'économie politique pure, ou théorie de la richesse sociale* (1874 and later editions), 127, 255, 262, 299 etc.
122. Lange, *op. cit.* in Note 115, 252-270; 269.
123. See A.C. Pigou, *The Economics of Welfare* (1920 and later editions), Part II, Chapter IX (in the 3rd edition, which Lange cited), "Divergences between Marginal Social Net Product and Marginal Private Net Product."
124. Lange, *op. cit.* in Note 115, 273-74.
125. Hayek, "Socialist Calculation: The Competitive 'Solution'," *Economica* (New Series) VII/26 (May 1940).
126. Lange, *op. cit.* in Note 115, 298-99.
127. Hayek, *op. cit.* in Note 5, 88-89.
128. Lange, *op. cit.* in Note 115, 361-64.
129. We will read with interest Kowalik's book in English about Lange, forthcoming from Macmillan (UK).
130. Hayek, interview published in *El Mercurio* (Santiago de Chile), 12 April 1981.
131. Mises, *Liberalism* (1927), 45.
132. Kowalik, *op. cit.* in Note 115, xxiii.
133. Kowalik, "Why the Social Democratic Option Failed: Poland's Experience of Systemic Change," in A. Glyn, ed., *Social Democracy in Neoliberal Times: The Left and Economic Policy since 1980* (2001). We will read with interest his book, *From Solidarity to Sellout: The Restoration of Capitalism in Poland*, forthcoming from Monthly Review Press.
134. See www.ncbi.nlm.nih.gov/pubmed/9508159.